AIRWAYS UPDATE

RADCLIFFE & Co
Independent Financial Advisers
Est. 1959

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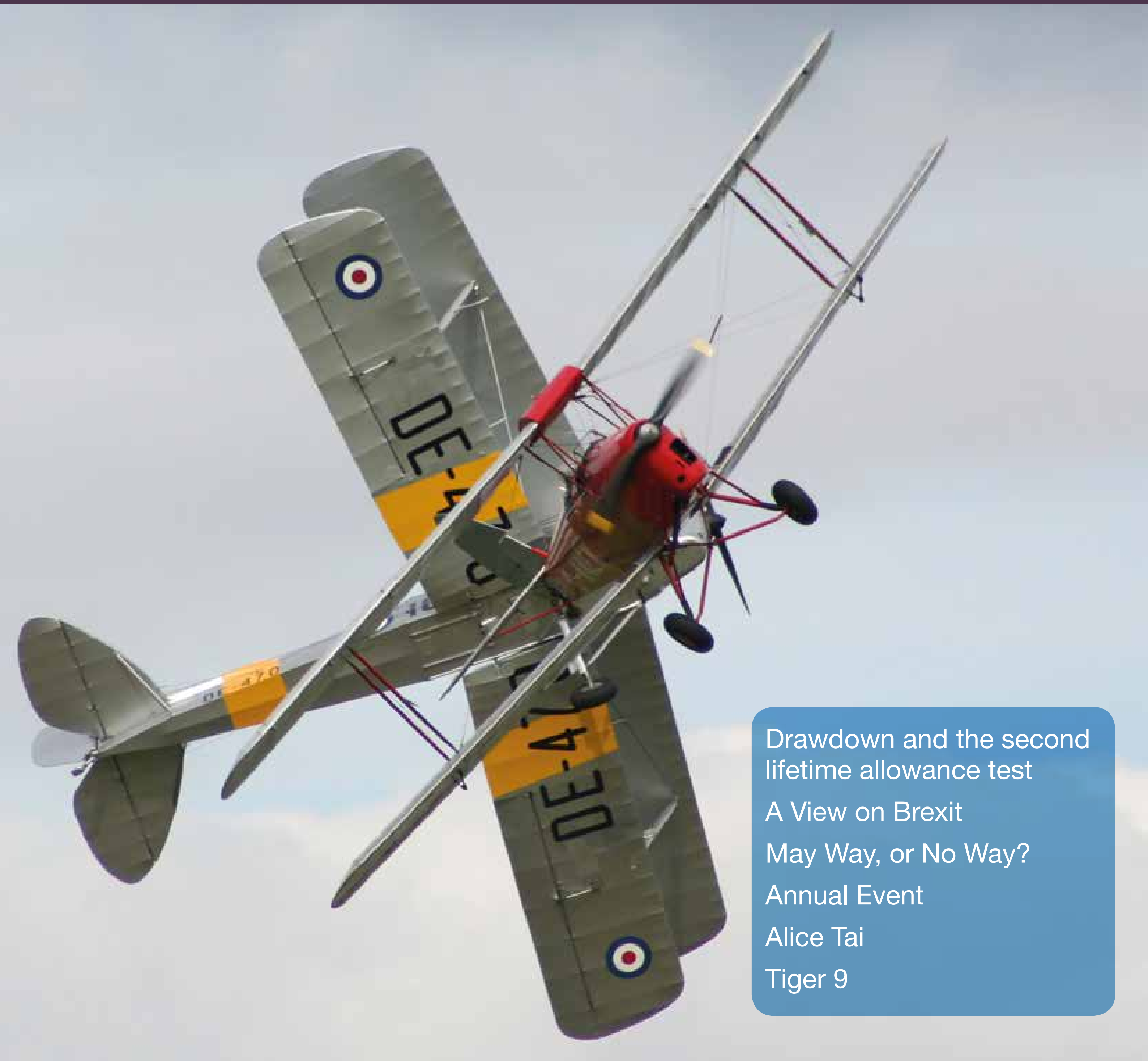

Drawdown and the second lifetime allowance test

With the standard Lifetime Allowance (LTA) at just £1,030,000 and more and more individuals choosing drawdown, the second LTA test has become a key planning consideration.

When you first move into drawdown you will trigger a Benefit Crystallisation Event (BCE) which tests the benefits being taken against your available LTA. There are two separate tests at this point, one for the tax free cash (TFC) and one for the amount moved into drawdown. Both BCEs will use up a certain percentage of your LTA. If the benefits taken together with all other previous benefits, are less than the LTA there is no LTA charge.

Example – Stewart

Stewart takes £200,000 tax free cash and moves £600,000 into drawdown in June 2017. This uses up 80% of the standard LTA (£1m at the time).

Where an individual's total benefits exceed the available LTA they are subject to a lifetime allowance charge. The charge is 55% where any excess is taken as a lump sum or 25% on any excess that is retained within the drawdown plan. The drawdown funds will also be subject to income tax as and when they are taken in the normal way.

Example – Graeme

Graeme has a fund value of £1.2m and no forms of LTA protection. He crystallises all his funds of the standard LTA (£1m at the time) in May 2017. The maximum tax free cash is limited to 25% of the LTA ie £250,000. £750,000 of the funds moving into drawdown are also within the LTA. For the excess of £200,000 he can either receive a lump sum net of 55% tax ie £90,000 or take the 25% charge and move an additional £150,000 into drawdown.

Example – Brian

Brian crystallises funds worth £1.2m in May 2007 when he reaches age 65. He takes £300,000 tax free cash and moves £900,000 into drawdown. The LTA at the time was £1.6m and so he uses up 75% of the LTA leaving 25% remaining.

In May 2017 the funds are still in drawdown and he faces a second LTA test at age 75.

Brian has taken no income from his fund and the £900,000 has grown to £1.25m, an increase of £350,000.

As he has 25% of his LTA available this equates to £250,000 of the current LTA of £1m. This means there is an excess of £100,000 and this is subject to an LTA charge of 25%.

At this point if there is an excess it is not possible to receive a LTA excess lump sum as this must be paid before age 75. The scheme administrator would pay the 25% charge on any excess to HMRC and the balance would be retained in the scheme.

If Brian takes even a modest income each year he can avoid the LTA charge.

However, for those using drawdown that isn't the end of the LTA, you also need to consider the second LTA test. The second LTA test occurs when you use your drawdown funds to either buy an annuity or when you reach age 75 – whichever is sooner. It then tests any increase in the fund value between the first BCE and the second.

For the second LTA test the original tax free cash is no longer relevant. The second test is only concerned with the increase in the value of the funds that were moved into drawdown.

The rules encourage individuals to take income. If you take income withdrawals of at least the equivalent of any growth there will be no increase in value and there can be no LTA charge at age 75.

Example – Julie

Julie crystallises funds worth £1.4m on her 64th birthday in May 2006 when the LTA was £1.5m. She takes £350,000 as TFC and moves £1,050,000 into drawdown. This used up 93.33% of her LTA leaving 6.67%.

In May 2017 she is subject to a second LTA test at age 75. She has been taking a regular income of around 4% a year from her fund which has been a little less than the income and gains achieved within the drawdown fund. The drawdown fund is now valued at £1,100,000.

The second LTA test looks at the difference between the current value and the initial value ie £1,100,000 - £1,050,000 = £50,000. This uses up a further 5% of the current LTA. As this is less than her 6.67% available LTA there is no LTA charge.

As there are no limits on the amount of income that can be taken via drawdown an LTA charge at the point of the second LTA test is largely optional. Where the total funds are in excess of the LTA, you have the choice of taking withdrawals that are subject to income tax or facing the 25% LTA charge at age 75 plus income tax charges later on the withdrawals. The former would usually be more favourable. If you have more than one drawdown plan in force at age 75 each one must be looked at separately and the charge will be based on the total of any increases in drawdown values. Any plans where there have been decreases in values are ignored. This means there is no opportunity to offset a 'loss' on one drawdown plan with a 'gain' on another in order to mitigate any LTA charge.

Age 75 uncrystallised funds

Even if you choose not to take any funds from your pension fund there is no avoiding the LTA test. This is because when you reach age 75 with uncrystallised funds in a money purchase arrangement the benefits will be tested at age 75. Here's hoping LTA is scrapped prior to turning 75!

You retain the right to receive up to 25% of your LTA as tax free cash, (or 25% of what was remaining of the LTA at that point if there were previous BCEs), and everything else will be subject to income tax at the time it is taken.

Death benefits and estate planning

In the event of death before reaching age 75 any uncrystallised benefits paid as a lump sum or beneficiary's drawdown are subject to an LTA test. However, any funds that are already in drawdown at the time of death are not subject to a second LTA test. In addition any funds remaining in drawdown post age 75 are not subject to a further test on death.

The improvement in pension death benefits following the pension freedom reforms has led to more wealthy individuals using their pension plans to help with their estate planning. Whilst you cannot avoid the LTA test at age 75, keeping the funds in the pension plan can still be an attractive option. They will face a 25% charge on any excess, however, if you have no need for the income and an estate in excess of the IHT nil rate band, this could be a preferable option. The funds can remain invested in a tax efficient environment and outside of your estate. You are free to pass any remaining funds on to whoever you choose after death. The beneficiaries will be subject to income tax at their own rates whenever they take the funds. This may be preferable to taking withdrawals that may be subject to both income tax at higher rates and to inheritance tax later if they are not spent or given away.

A View on Brexit

There has certainly been a lot of noise around a Brexit no deal, however what is perhaps most striking is that it has had little impact on equity markets. To us, this is not unexpected, with the market currently not panicking and the belief that there is still time to secure a deal. The only reaction we have seen is the slight further weakening of the pound, something we would expect to be much more extreme in the actual event of a no-deal. As we saw in the aftermath of the Brexit referendum, a weakening pound is actually very good news for the FTSE 100 (despite the initial negative reaction), with such a large proportion of its constituents' earnings coming from outside of the UK (around three quarters). Therefore, perhaps rather ironically, portfolios may actually fare better in this weaker pound scenario than were we to see a rapid resolution to the Brexit deal and a much stronger pound (although I am sure you would agree that this is very unlikely!).

Given the increased risk of a 'no deal', we remain underweight in our exposure to domestically focussed UK companies, instead favouring global earners within our UK exposure and continue to have an overweight exposure to overseas investments and the dollar. It is also worth noting that we are retaining a good exposure to non-equity investments, including absolute return funds, infrastructure and bonds, which are not reliant on stock markets to produce an investment return.

It is also worth remembering that Brexit is also a UK and Europe centric issue, and stock market returns are usually based on the performance of the companies within them over the medium to longer term. Therefore, overall global GDP growth, more influenced by the likes of the US and China, is far more likely to drive equity market returns. In this regard, global GDP growth still looks robust and gives good companies the chance to thrive and improve earnings and dividends. If we are able to select the best companies and markets (as we always aim to do) then despite the undoubted challenges and political noise we will see over the next year, there are still good prospects for making decent returns.

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Going into a little more detail, taking a more glass half empty view (and the reason we are underweight domestic UK stocks), a much weaker pound is likely to push up inflation, renewing the squeeze on consumers real incomes. Business confidence would also be hit further. There is little doubt that a no deal would impact UK GDP growth next year (as it arguably has already over the past year or so). However, a no deal on trade doesn't have to mean a no deal on everything and reverting to WTO rules would not be the end of the world. While the UK would face the EU's Common External Tariff on its exports to the EU, tariff rates are on average low at 4% (on a bad day, exporters see exchange rate movements bigger than this and they would most likely gain from a weaker pound). Leaving without a deal would also mean that the UK would not have to pay its 'divorce bill' of around £40bn, equivalent to around 2% of GDP and this could be used to offset the adverse effects on the economy and support the hardest hit sectors.

To summarise, we continue to monitor events closely and would be prepared to position portfolios much more cautiously if required. However for now, whilst we feel it is prudent to remain diversified and have a bias to global equities which are less sensitive to the UK, we feel it would be dangerous to be too cautious, particularly as stock market returns towards the end of an economic cycle can be very strong and underlying company and economic results are still encouraging.

May Way, or No Way?

Once again the headlines are full of Brexit stories, with the focus very much on Mrs May's opinion that the process will either follow the path set out in the Chequers plan or that it will be a "no deal" departure. While we all have our personal opinions on the merits of either outcome, from an investment perspective our responsibility is to assess the facts that are available to us (which are, admittedly, few), judge the risks and rewards and then take appropriate action in portfolios. We are receiving an increasing number of enquiries from clients who are worried by the "hard Brexit" headlines, especially as these are being used by the Remain/"soft Brexit" camp to stir up fears of severe economic dislocation. Understandably, people are worried that this could have a deleterious effect on their investments. "Hard Brexit" is not our central case, but hopefully our analysis will help to sooth some fevered brows.

I should initially point out two big differences between now and the Brexit referendum in 2016. First, Brexit itself is a process, whereas the referendum was an event. Thus whatever consistency of Brexit we end up getting should become clear over the months leading up to March 29th next year. The shock factor that accompanied the referendum result will be materially reduced - markets tend to act better when they have time to absorb new influences rather than being confronted with them in the small hours. Furthermore, the Brexit process comes in two parts. First the separation agreement must be reached, and that will (we hope) be done by March. Then comes implementation, which will take at least until the end of the proposed transition period (ending 31st December 2020) and possibly longer by mutual agreement. We are also of the opinion that even if there is a risk of "no deal", the circumstances will be important: if it's the UK government being petulant, then that promises trouble; if it's more a failure to dot 'i's and cross 't's owing to the sheer complexity of the process, then the EU (and markets) might cut some slack.

Second, the world is a different place now. While there are plenty of things to concern global investors, not least the potential negative effects of nationalism, isolationism and trade wars, we no longer appear to be in the grip of "secular stagnation" fear as we were in 2016. The US 10-year Treasury yield hit its all-time low of 1.358% on 8th July 2016, with the last leg down starting as the referendum result emerged. It is currently 2.99%, with rising inflation potentially seen as the greater threat. Germany's 10-year Bund yield (now 0.45%) bottomed on the same day at a remarkable minus 0.18%. The UK 10-year Gilt yield (today 1.53%) troughed at 0.518% on 12th August. Brexit currently has less capacity to put the wind up global markets.

For the purposes of our scenario analysis, we define a "no deal hard Brexit" as the one with the greatest negative economic impact on the UK, without necessarily having to be specific about the details (eg food shortages, queues of lorries stretching back from Dover to the M25, etc). We then look at the potential impact on the main asset classes within a balanced investment portfolio. To a great degree the playbook is based on the experience from 2016, but with the caveat of those differences outlined above.

The big mover last time was the pound, which fell sharply, and although it is by many measures a lot cheaper now, it still looks vulnerable, especially if investors price in a negative adjustment to our terms of trade with Europe and the rest of the world. Even some pro-Brexit economists are prepared to acknowledge that "no deal" means pain initially. Foreign exchange markets remain the easiest and most liquid forum for traders to express their opinions, and so sterling will be in the front line. The consensus opinion is for a further fall of around 10% against the dollar and the yen, with a 5% fall against the euro, as the Eurozone will itself be affected. As in 2016 this will cushion UK equities owing to the high proportion of overseas earnings (@75% for the FTSE 100, @50% for the Mid-250). European equities might come under a modicum of pressure, but US and Asian markets will not be affected. Put that all together, and a globally diversified equity portfolio measured in sterling should rise in value.

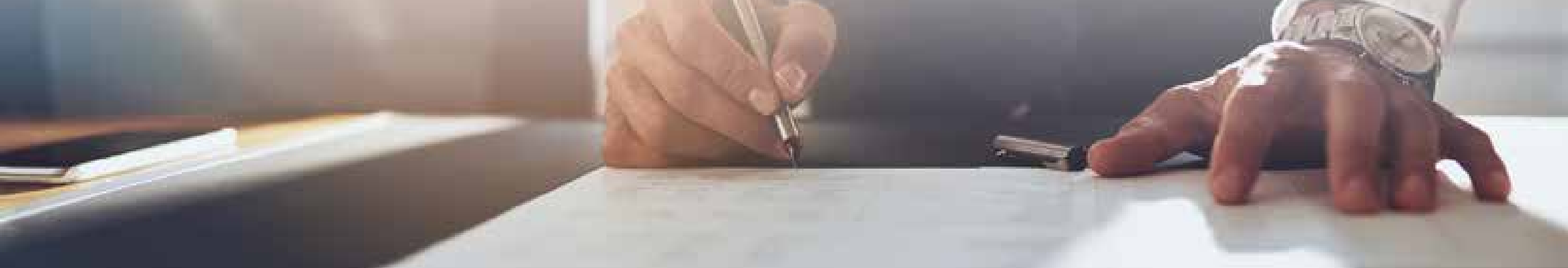
UK bonds will be subject to opposing forces. On the one hand higher inflation (thanks to the weaker pound) and the threat of larger fiscal deficits call for higher yields (tax receipts would come under pressure, and either a chastened Tory government or a potential newly installed Labour government would be urged to spend more). On the other, gilts would serve their purpose as "safe haven" assets, and we are inclined to believe that the Bank of England would react by reversing recent interest rate increases and possibly restarting asset purchases (Quantitative Easing). On balance, as in 2016, we see the bond bulls winning.

Alternative assets (hedge funds, absolute return funds, infrastructure vehicles, structured products, etc) should provide a welcome counterweight to any increased volatility, but the majority of any returns will probably come as a result of their currency exposure.

Overall our conclusion is that a typical balanced portfolio will not correlate with the UK economy (but will be highly influenced by events in, say, the US or China). A "no deal" Brexit could result in a higher valuation, but that must be put in the context of diminished purchasing power owing to higher domestic inflation and more expensive trips overseas.

John Wyn-Evans

Head of Investment Strategy



The Aviation Team at Radcliffe & Co

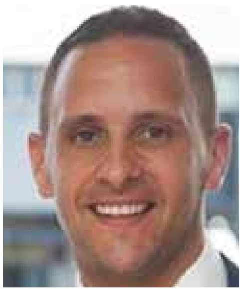
Darren Fulford

Darren joined Radcliffe & Co in 1988 as a financial adviser, having previously worked for Legal & General for many years as an inspector. He joined the main board of Radcliffe & Co directors in 1998 and was subsequently appointed as the finance director, company secretary and compliance officer. He has seen the company go through many changes in his career and has helped it to develop in many areas. Darren provides support and advice to the Aviation Team.

Chris Selfe

Chris has worked for Radcliffe & Co for 16 years and has practiced as a financial adviser since graduating from Stirling University in 1992. His focus is on helping high net worth clients with their financial planning and he advises a large number of British Airways clients. The vast majority of his clients are introduced to him by personal recommendation. Chris has recently been appointed to the management team with responsibility for the firm's business development. His hobbies include rally driving, skiing and mountain biking.

Jimeel Angel



Jim is a chartered financial planner with over 20 years of industry experience. He joined Radcliffe & Co in 2012 and now forms part of the management team with responsibility for the firm's IT & marketing. He started his career in 1997 as a stockbroker locally, after which he moved to London to become an international equity and foreign exchange trader. He made the move in to financial services in 2002, working for two of the industry's largest insurance companies.

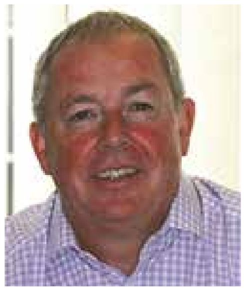
Katie Steel

Katie is a chartered financial planner with 12 years of industry experience. She joined Radcliffe & Co in 2012 and studied to become a chartered financial planner. She started her career in 2006 working for Halifax South East Property Unit, after which she moved to Skandia which later became Old Mutual Wealth and conducted an array of different roles which built her experience in a number of areas.

Jack Igglesden

Jack joined Radcliffe & Co in May 2010 as a trainee financial adviser and part of his training was working in our administration, corporate and paraplanning departments over the years to gain experience across different areas of the company. He qualified in August 2014 and was promoted to independent financial adviser on the 1st of May 2015. Jack enjoys all sport but spends the majority of his time playing football, golf or cycling and during the winter months he is also an avid snowboarder.

Neil Igglesden



Neil has worked as a financial adviser since joining the company in 1993. He became a director in April 2003 before being appointed managing director in 2012. Prior to joining Radcliffe & Co in 1983 he became an inspector with Scottish Provident after qualifying as a navigating officer with Mobil Shipping between 1978 until 1983. Neil also holds the G60 qualification which allows the company to advise on Occupational Pension Schemes.

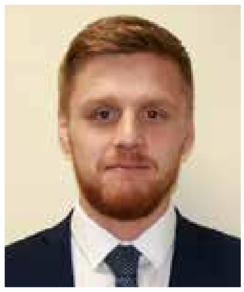
Jacqueline Moore

Jacqueline, who is a chartered financial planner with over 30 years' experience in the financial services industry, joined Radcliffe & Co in 2010. She is a specialist in final salary pension schemes, retirement planning and inheritance tax planning although has a wealth of knowledge and experience over a wide range of topics. A specific focus of Jacqueline's is annual allowance (AA) and lifetime allowance (LTA) tax planning; extremely topical issues for many. Jacqui is a keen skier and cyclist.

Chris Headford

Chris has been a financial advisor for the last 24 years. Initially starting at Friends Provident, he then joined Independently Financial which merged with Radcliffe & Co in 2002. He is now part of the management team with responsibility for the investment committee which was founded in 2006.

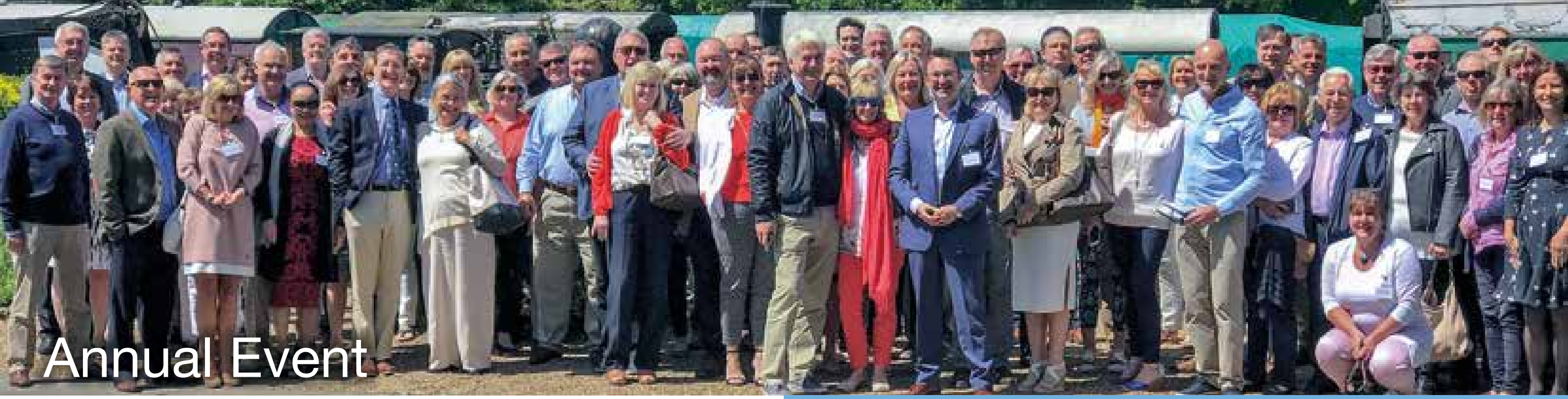
Calum Brockway



Calum joined Radcliffe & Co back in March 2010, initially as a junior administrator. He gained experience in this role among others before completing his diploma in regulated financial planning to become an IFA. He is currently studying for his chartered status having already completed his first exam. In his spare time he enjoys football, golf, and loves walking his little black labrador, Poppy.

Katie Tulk

Katie joined Radcliffe & Co in 2015 after working for Old Mutual Wealth as a technician and workplace coach. Katie is client co ordinator for our airways clients. Katie is currently working towards a diploma in regulated financial planning and hopes to become a financial adviser in the future. Katie loves travelling, yoga and baking.



Annual Event

In May, Radcliffe & Co was delighted to host our annual Investment Day, designed exclusively for our airline pilot clients. These events include an overview of the markets and other topical issues, together with time to catch up with the team from Radcliffe & Co and many of your colleagues, past and present, over a relaxed lunch. Every year we try and find an interesting venue and this year's proved very popular, being held at the Bluebell Railway in the stunning Sussex countryside.

After interesting presentations from Brooks Macdonald and Ingenious Investments, we headed to Horsted Keynes station to board the final Bluebell Express steam locomotive of 2018, chartered exclusively for our guests. As we rolled through the bluebell woods in brilliant sunshine we were treated to a silver service lunch and enjoyed our luxurious surroundings – a far cry from most modern train journies!

At Radcliffe & Co our business has always relied on word of mouth recommendation and it is thanks to many of you that literally hundreds of aviation clients have chosen to transfer their pensions through us. We are all very grateful for your ongoing support.

We are currently planning several future events, including Investment Evenings with theatre trips in both Manchester and Glasgow for our more northerly aviation clients.

Our next annual Investment Day will be held in May 2018 and we will be in touch with more information in the New Year.

Alice Tai

Back in 2012 we were delighted to start our sponsorship of a then 13 year old Paralympian hopeful, who was born with severe bilateral club feet.

Now aged 19, Alice Tai has won medals at Paralympic, World and European levels. Her debut Games in Brazil saw Alice compete in five events and take relay gold in the Women's 4x100m Medley relay and individual bronze in the Women's S10 100m Backstroke.

Alice returned to the international stage again in Dublin this summer for the World Para Swimming European Championships where she won a total of four gold medals and European titles. This comprised of three individual medals and one in the 4x100m Medley Relay with the victory sealed in world-record time!

With such determination from an early age we are delighted to continue our ongoing support and sponsorship.

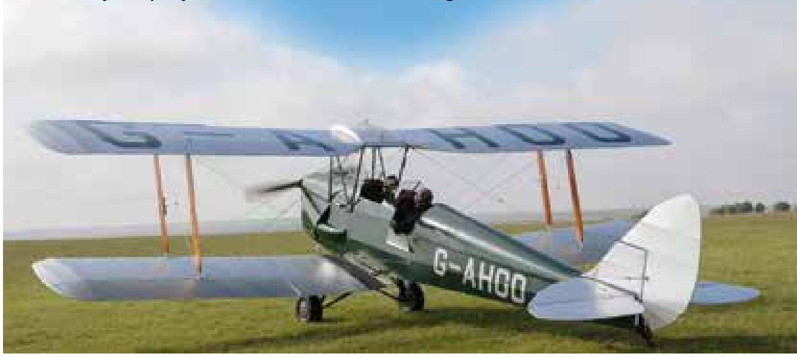
Tiger 9

The de Havilland DH 82 Tiger Moth is a 1930s biplane designed by Geoffrey de Havilland and was operated by the Royal Air Force (RAF) and others as a primary trainer. The Tiger Moth remained in service with the RAF until replaced by the de Havilland Chipmunk in 1952, when many of the surplus aircraft entered civil operation. Many other nations used the Tiger Moth in both military and civil applications and it remains in widespread use as a recreational aircraft in many countries.

The Tiger Nine formation team was formed in the summer of 2005 in response to the request for a flypast of nine Tiger Moths at the 25th de Havilland Moth Club rally at Woburn Abbey. Based on a core of former Diamond Nine members, a new team, led by Jeff Milsom, engaged in a series of practice sessions, necessary to achieve the objective of flying the large close formation flypast at Woburn. This was achieved successfully, and was enthusiastically received by the club. Having risen to the challenge; the newly formed team went on to develop their full display routine for the next season.

The Tiger Moth is rarely the first choice of machine for a formation display, with its sluggish aileron control, low power, poor visibility, lack of brakes and no electric starter, it requires a mature discipline to minimise the risks involved with operating a large group of Tiger Moths simultaneously. There is, however, something very British about doing it the hard way for the sake of it, and having risen to the occasion the newly formed group had a thirst for more.

The simple flypast evolved into the current display, which has been designed to keep the crowd entertained throughout the display. This is the only display in the world to have 9 Tiger Moths in close formation.



AIRWAYS UPDATE is produced by Radcliffe & Co to provide information and helpful guidance on financial matters, issues and developments that will affect individuals and their families.

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